REPORT ON
CANADA MORTGAGE AND HOUSING CORPORATION

Executive Summary

October, 1979

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1 INTRODUCTION

Cabinet directed that the Task Force on Canada Mortgage and Housing Corporation study the potential for privatizing the activities of CMHC (as opposed to privatization of the Corporation itself) and encouraging the private sector to take a larger role in these activities. To reflect the unusual position occupied by CMHC in serving both departmental and financial roles, the general definitions of privatization have been adjusted to encompass:

a) the discontinuation of the activities of the Corporation with any assets disposed of in whole or in part to the private sector or to the provinces; and

b) the discontinuation of the activities of the Corporation with each activity being undertaken in whole or in part by the private sector or by the provinces at their own risk or on the basis of some form of contract or subsidy arrangement with the federal government.

The objective of this report is to assess the options for privatization, not in terms of any absolute dogma, even that of privatization, but rather in terms of a realistic appreciation of the future housing needs of Canadians in all regions of the country and the most effective ways in which those needs can be met in a free and pluralistic society such as ours. We do not reject at the outset any role for the federal government in meeting those needs; but neither do we assume that it must automatically and in all circumstances play the leading role and bear the major share of the responsibility for meeting housing needs.

We have tried, in this report, to consider objectively the areas in which government activity remains necessary and desirable, as well as those in which the private sector may be able to do the job better. And,

while we argue for a change in the balance between the public and private sectors in the housing field, we respect and wish to maintain the tradition of co-operation that has long existed between public and private enterprise in this area of activity. The federal government in general, and Canada Mortgage and Housing Corporation in particular, have a long and honorable history of involvement in housing and mortgage markets, and we have no intention of suggesting that this should be otherwise in the future.

The views expressed in this report were thoroughly discussed by all concerned and represent a unanimous concensus of the Advisory Committee. This document, while being published under the authority of the Government of Canada, is not a statement of government policy, nor should it be assumed that the government agrees with all aspects of the analysis contained in the report.

2 EVOLUTION OF AND RATIONALE FOR HOUSING POLICY

A Evolution of Federal Housing Policy

The evolution of housing policy and the philosophy behind it have, in large part, been in response to changing market needs and to changing social and economic environments.

Federal government involvement in the housing sector began on a continual basis in the 1930's in an effort to stimulate demand and employment. These objectives continued during the late 1940's and early 1950's in conjunction with attempts to increase the availability of resources for housing. In the mid-1950's the emphasis of federal policy shifted to increasing the availability of funds to finance residential construction; this objective dominated housing policy into the mid-1960's, although the long term objective remained the stimulation of housing demand. In the late 1960's, the emphasis shifted again to social policy and income redistribution. Provinces became active in the housing policy area and the early 1970's could be characterized as a period of joint

federal-provincial programming. By the mid-1970's, both the federal and provincial governments retracted from this approach.

In the last two years, the policy objectives of CMHC have focussed on the provision of housing for low income groups and providing assistance to municipalities for community services. Provincial housing programs remain varied across the country and relate to the specific market conditions in each province.

B Rationale for Housing Policy

The traditional economic rationale for government involvement in the housing sector is: (a) to compensate for market imperfections in the allocation of capital and resources to the housing sector; (b) to reflect social benefits in excess of private benefits (technically called 'externalities') in the production or consumption of housing services; (c) to redistribute income; and (d) to reduce cyclical fluctuations in residential construction.

Market Imperfections

Market imperfections have historically impeded the flow of funds into housing because of the nature of the mortgage instrument and lagged and incomplete mortgage interest rate adjustments, but these imperfections have largely been removed as a consequence of CMHC activities (primarily federal loan insurance and related activities) and private sector flexibility. As a result, mortgage investments should no longer be considered a residual outlet for investment funds in Canada and substantial government intervention is no longer necessary on this ground. On the other hand, some intervention may be necessary occasionally to compensate for market discrimination if it arises against special groups or remote regions or, on a contingency basis, in case new market imperfections appear. Market imperfections in the allocation of real resources, such as land and labour, appear not to

warrant major concern at the present time and, to the extent they exist, are likely to be amenable to competition policy or provincial action.

Social Benefits

When the social benefits associated with improved housing exceed the private benefits, a rationale for government involvement in the housing market exists to compensate for the consequent deficiency in resources going into housing. However, such social benefits appear to exist only in cases of extreme deprivation in housing facilities, and there is no evidence to suggest that such deprivation currently exists in Canada. The possibility exists for socially negative impacts on neighbourhoods to arise from undesirable land uses, but these impacts are local in nature and local government zoning regulations can be used to prevent such land uses.

Income Redistribution

Housing policy is often used to redistribute income toward lower income households. Traditional economic theory, on the other hand, suggests that unrestricted cash transfers are more efficient and appropriate than in-kind transfers in modifying the general availability of goods and services to various members of society. Consequently, if income distribution is the sole objective, the use of housing policy is justified only if unrestricted cash transfers are not politically feasible. If, however, the social objective is not solely income distribution but is specifically related to increasing the housing consumption of low income households, housing related transfers may be appropriate, but the government must be mindful of the possible market distortions this procedure entails. In the event housing policy is to be utilized for income redistribution, federal government control is appropriate since the provinces which can least afford a redistribution policy are those which have a disproportionate share of households requiring

assistance. Moreover, the federal government is best able to ensure that differences in redistributive policy among provinces do not lead to artificially induced inter-provincial mobility or to gross inequities betwen individuals in similar circumstances across provinces.

Reduce Cyclical Fluctuations in Residential Construction

Federal policy to reduce cyclical fluctuations in residential construction activity is often advocated because residential construction is one of the most volatile sectors in the economy and because this volatility is often accentuated by the disproportionate impact monetary policy has on it. Residential construction tends to fluctuate in an anti-cyclical pattern, tending to increase during periods of sluggish or declining general economic activity, and to decrease during periods of marked economic expansion. The explanation for this hinges on the behaviour of the capital market and the interest sensitivity of housing demand. These factors also explain the disproportionate impact of monetary policy on housing.

From a macro-economic viewpoint fluctuations in housing are generally desirable because they mitigate general economic instability. From a housing sector viewpoint, on the other hand, fluctuations are undesirable since the boom or bust cycles increase housing costs, bankruptcies, and inefficiencies and lead to under-capitalization in residential construction with a resultant reduction in the long run allocation of resources for housing. However, unless a housing contraction is extremely severe or prolonged, long run resource allocation is unlikely to be significantly affected and there is little reason to specifically stabilize the residential construction sector. But, if contractions are likely to be excessive as a consequence of an extraordinarily strong application of monetary policy for general macro-economic purposes (for example, for exchange rate purposes), the use of specific anti-cyclical housing policies is justified.

Furthermore, the use of housing policy in this manner would not conflict with macro-stabilization and may enhance it by allowing monetary policy to be more stringent than otherwise might be possible because of its disproportionate impact on the housing sector.

3 HOUSING CONDITIONS AND FUTURE TRENDS

A Housing Conditions

The quality and standard of housing in Canada is currently unsurpassed. This is evidenced by the fact that only 2 to 3 per cent of the dwellings in Canada could be defined as dilapidated or lacking basic facilities in 1976. With respect to the availability of housing space, only 2 per cent of all households consist of double families (i.e., more than one family sharing a dwelling unit) and only 4.3 per cent of households have more than one person per room. Finally, with respect to affordability, the Urban Family Expenditures Survey of 1976 suggests that on average the percentage of income spent on shelter by homeowners was 15.1 per cent, with renters spending 16.3 per cent of income on shelter. This indicates that the average proportion of income spent on housing is substantially below the 25 to 30 per cent rule of thumb.

Despite the extremely high quality and general affordability of housing, certain groups are experiencing hardship. The high proportion of income spent on housing by low income families, often over 40 per cent of income, indicates that these families have primarily an income problem rather than a housing problem, for they are unable to acquire suitable housing at an appropriate housing expenditure to income ratio. There are, as well, however, some low income households whose shelter is physically dilapidated and requires rehabilitation to bring it up to acceptable standards. It is estimated that 438,000 households pay over 30 per cent of gross income for shelter and/or live in sub-standard dwellings.

Other groups of low income families are the native peoples and rural households that may have housing

problems in addition to income problems, in the sense that higher incomes might not ensure adequate housing would be built for them.

B Future Trends in the Housing Market

The outlook for the 1980's is predicated on the absence of a high pent-up demand for housing, slower increases in real incomes, and unfavourable demographic forces. The enormous past accomplishments of the housing industry, the financial industry and government have produced a virtually unsurpassed stock of housing for Canadians, with almost no significant pool of unsatisfied housing requirements. It is unlikely, given the expected economic forecast, that there will be additional impetus in demand from a sharp acceleration in the growth of real incomes. Finally, an important aspect of the outlook for housing is the emergence of negative demographic influences. Net household formation in the high housing demand age classifications is expected to decline. The brunt of the unfavourable demographic forces should begin to hit the single family market just before the middle of the 1980's and consequently single family housing starts can be expected to decline substantially after that. Overall, net housing requirements are expected to peak in 1981 at 237,000 units and then decline steadily over the decade to 165,700.

4 CMHC AND OTHER FEDERAL PROGRAMS AND POLICIES

The federal government exerts a significant impact on the housing sector through a number of vehicles, the most important of which are CMHC and the Income Tax Act. Since this examination is intended to focus on CMHC, emphasis is on its activities. Some consideration is also given to the use of the tax system to influence the housing sector, but there is no discussion of the impacts of monetary policy as it is conducted for general macro-stabilization purposes rather than as a housing policy.

A CMHC Programs

CMHC is a crown corporation which performs both financial and departmental roles on behalf of the government. In its financial capacity, CMHC functions as an insurer and as a financial intermediary. As an agent of the government, CMHC operates the Mortgage Insurance Fund, which receives fees for underwriting insurance and dispenses funds for settling claims. As a financial intermediary, CMHC borrows funds from the Department of Finance and lends these funds for housing purposes. In its role as a government department, CMHC administers subsidies to various groups or individuals, provides policy advice, and conducts research. Funds required for these purposes are provided to CMHC through annual allocations appropriated by Parliament. Unfortunately for exposition purposes, CMHC's roles are often integrated and in many of its programs more than one function is performed.

The major on-going programs of CMHC are described briefly below.

Mortgage Insurance

Under the National Housing Act (NHA), CMHC insures loans made by private approved lenders against loss through default. CMHC imposes specified requirements with respect to construction standards, amortization period, maximum loan to value ratio, maximum loan amount, and maximum ratio of taxes and debt service to income for a loan to qualify for NHA insurance. The borrower pays an insurance fee into the Mortgage Insurance Fund and with this insurance is better able to obtain mortgage financing.

CMHC mortgage loan insurance has been provided since 1954 and has contributed significantly to the development of the private mortgage lending industry in Canada. One such development is the emergence of private mortgage insurance which is now provided by two private companies, Mortgage Insurance Company of Canada and Insmor Mortgage Insurance Company. These private

companies now compete with CMHC for many classes of loans, although there are still some significant differences in the nature of the insurance and the process through which it is provided. First, the inspection process and the enforcement of standards is generally thought to be more stringent and rigid for NHA insured loans than for privately insured loans, giving greater protection for borrowers and lenders. Second, NHA insured loans take longer to approve. Third, NHA insurance has government backing and thus is often considered as offering a greater form of protection. Fourth, NHA insurance has been used as a vehicle for the propogation and adoption of site planning guidelines, amenity guidelines, and other environmental considerations. Fifth, the terms that qualify for NHA insurance have occasionally been varied to influence the cyclical availability of private mortgage credit; however, such variations have almost always been in the direction of greater ease and thus this anti-cyclical role has been relatively minor. Sixth, CMHC periodically insures loans that would not qualify for private insurance, but when this is done CMHC is really using the insurance program to perform its departmental role.

Although the contributions of NHA insurance to the development of the private mortgage market have been substantial, many of the functions it now performs can be obtained in the private sector or through other planning devices.

Direct Lending

CMHC may make any type of loan that may be made by an approved lender, if the loan is not available to a satisfactory applicant through an approved lender. While this program has been used extensively in the past, especially during the period when the level of NHA interest rates was determined by the federal government, direct loans are only currently available on a very limited basis in geographical areas that are not normally serviced by approved lenders.

Public Housing, Non-Profit and Co-operative Housing, and Differential Interest Contributions

In the past, CMHC provided loans to provinces, municipalities, or public housing agencies for the development of public housing through two schemes. In the first scheme, CMHC provided 90 per cent of the total capital cost in its financial role and then in its departmental role undertook responsibility for making annual grants to cover 50 per cent of the operating losses on the project. In the second scheme, CMHC provided 75 per cent of the capital costs and undertook responsibility for making annual grants to cover 75 per cent of the operating losses. Capital advances under both schemes were largely terminated in 1979 and replaced by the differential interest programs, but expenditures will continue to escalate over the foreseeable future because of previous commitments. Over the 1979-84 period, annual expenditures for CMHC's share of the losses are estimated to be roughly $300 million.

CMHC also made loans at subsidized interest rates to persons or organizations providing housing to the elderly or low income groups at below market rents, to non-profit organizations formed for charitable purposes, and for non-profit and co-operative housing groups. These lending activities were largely terminated prior to 1979 and have also been replaced by the differential interest programs.

Differential interest contributions to public and private non-profit housing corporations and housing co-operatives are the cornerstone of the revised social program introduced by CMHC in 1978. Under this program, CMHC provides explicit subsidies to the corporations or co-operatives. The maximum subsidy is equal to the difference between their actual interest costs and those which would have been incurred had the interest rate been 2 per cent. The program arises in CMHC's departmental role since this is purely a subsidy program. Loans for the projects are to be obtained from private lenders with CMHC insuring against

default, although CMHC retains a small residual lending role to ensure that funds are available in smaller communities where private lenders are not active. Although current expenditures are relatively small under these programs, expenditures will increase dramatically as they evolve, and it is estimated that by 1984 these programs will involve roughly $250 million in annual subsidy expenditures.

Rehabilitation and Home Insulation Programs

CMHC provides loans and grants to individuals for rehabilitation of existing dwellings and for insulation of these dwellings. In the case of rehabilitation, loan forgiveness grants are also provided for low income households. Under the home insulation programs, grants of up to $500 per unit are provided, based on insulation expenditures but not recipient income. The subsidy component of the rehabilitation program is expected to average $135 million per annum from 1979-85 if it continues in its present form. Subsidies involved in the home insulation programs are expected to average approximately $165 million per annum from 1979 to 1985.

Community Services Program

Prior to 1979, CMHC provided loans to provinces and municipalities to finance land assembly, neighbourhood improvement, and the installation of trunk, storm, and sanitary sewers as well as water supply projects, and grants to defray the costs of these activities and encourage municipal development. Although all these programs have been terminated, past commitments outstanding are significant and will continue to impose a financial drain for a number of years.

In 1979, a global funding approach to federal financial aid to municipalities was adopted and the Community Services Program replaced the Neighbourhood Improvement Program, the Municipal Infrastructure Program, and the Municipal Incentive Grant Program. Under the new

program, CMHC no longer plays a role as a financial intermediary but rather plays the role of a department by providing explicit subsidies. In 1979, CMHC made commitments of $150 million under the new program and, in 1980, CMHC will increase its long term funding to a level of $250 million per year.

Rural and Native Housing

In an attempt to improve the qualitative and quantitative nature of rural and native housing, CMHC has initiated special programs in all its capacities. It thus has supplied loans, grants, and subsidies to this end.

B Housing Impacts of the Tax System

The tax system exerts a significant impact on the allocation of resources into housing through positive and negative income tax incentives. The most important of these incentives include the property tax and mortgage interest tax credits, the Registered Home Ownership Savings Plan, the exemption of principal residences from capital gains taxation, the allowance or disallowance of capital cost allowances for tax shelter purposes, the absence of roll-over provisions with respect to the recapture of capital cost allowance, the setting of capital cost allowance rates at other than true economic depreciation, and the non-taxation of imputed rents. Because these tax features significantly affect the desirability of investing in or consuming housing services, they exert a substantial impact on the housing sector. They also have significant implications for government tax revenues.

5 FINANCIAL OPERATIONS OF CMHC

As has been described in preceeding sections, CMHC operates both in a financial role in its insuring and intermediary capacities and in a departmental role in its social capacity. In order to assess the financial implications of its operations, each of its roles and

functions should be analyzed separately. Unfortunately, CMHC's budgetary and funding procedures are not allocated in this manner and consequently considerable difficulty was encountered in attempting this. Nevertheless, such an analysis is necessary and an attempt was made to impute costs to the various activities of CMHC. The procedure was to first segregate the financial flows associated with each function, to analyze the implications for CMHC's financial structure, and to indicate impending financial problems.

A Insurance Activities of CMHC

In its insurer role, CMHC underwrites NHA mortgage insurance and administers the Mortgage Insurance Fund (MIF). CMHC receives a fee of $35 per unit for originating insurance, and this fee goes into its operating revenues to help defray its origination costs which come out of its operating budget. CMHC also receives an insurance fee generally of 1 per cent of the amount insured which goes into the segregated MIF. Until the early 1970's, disbursements from the MIF occurred only to settle insurance claims, although disbursements now also occur to partially reimburse the operating budget of CMHC for costs related to administering the fund.

The true financial implications of the insurance function are difficult to ascertain because of the procedures followed. At the end of 1978, CMHC had a balance of $631.6 million in the MIF and $673 million in all its funds (it also administers the Home Improvement Loan Insurance Fund, the Rental Guarantee Fund, and the Home Insulation Contribution Fund), compared to contingent liabilities of $21.3 billion. However, its reserves do not reflect the excess of insurance-related premiums over outflows because the costs of administering the fund have largely been incurred as part of CMHC's general operations. Moreover, CMHC subsidizes the insurance operation because the $35 origination fee is substantially below the true origination costs which appear to range from $40 per unit for large multiple unit projects to $300 per unit for new single family

units. Finally, the actuarial amount of margin implicit in the reserves of the MIF is difficult to determine despite the subsidy from the general operations of CMHC since a set insurance fee has been charged on all its insurance, regardless of the risks associated with the loans. Since some insurance is on relatively high risk loans made by CMHC in its combined department and intermediary functions while other insurance is on private market lender loans, the variance in risk is substantial.

A number of financial problems are implicit in CMHC's insurance operation, the most important of which are the inappropriate origination and insurance fees, inappropriate allocation of costs and fees, and losses associated with and implicit in the portfolio composition of the MIF, and the lack of liquidity of the fund.

Inappropriate Origination and Insurance Fees

Since CMHC charges only $35 per unit for originating its insurance and experiences costs of $40 to $300 per unit, CMHC incurs a substantial loss on in its origination activity. This loss has been estimated to approximate $15-$20 million in 1979, and could be avoided by charging an appropriate fee. Moreover, the benefit of the reduced fee goes to all NHA lenders, contractors, and NHA insured borrowers regardless of income or social need and hence is an inappropriate subsidy from a social viewpoint.

Because CMHC charges approximately the same insurance premium for all its loans with only slight differences for rental versus ownership loans, its insurance premiums are inappropriate and may be too low on some of its insurance. This is especially true of insurance on social loans made directly by CMHC and graduated payment multiple unit residential building (MURB) loans made by the private sector. As a result, a disproportionate number of high risk loans are presented to CMHC for insurance, increasing their selection and origination costs and, when accepted for insurance, generating fees below those actuarily

appropriate for the risk, which could jeopardize the MIF and leave large uncovered contingencies. The loss due to this inappropriate fee structure is impossible to determine at this time but is likely to be substantial.

Allocation of Costs and Fees

Because the insurance origination and administrative costs are not explicit but are part of CMHC's general operating activity, the true financial implications of the insurance operation are unknown. As a result, CMHC has no check to ascertain its efficiency and thus operating efficiency is not directly encouraged, probably increasing the overall cost of this operation.

Portfolio Composition Changes in the MIF

The composition of the MIF asset portfolio has changed drastically in recent years as a result of a large volume of defaults on high risk insured loans. These defaults resulted in the MIF acquiring substantial real estate holdings and, in conjunction with the disposition of some of these holdings, mortgages that it issued to effect dispositions. In mid-1979, real estate and mortgage holdings accounted for 72 per cent of the MIF portfolio, compared to only 28 per cent at the end of 1977. This situation has a number of important implications.

First, the rapid rate of real estate and mortgage acquisition indicates a substantial amount of high risk insurance and suggests a period of continued high default rates. Second, the high proportion of illiquid real estate and mortgage assets in the fund substantially reduces the liquidity of the MIF and significantly increases its vulnerability to future claims. If the rate of liquidity loss of the last year were to continue, there is a very real possibility that the MIF will not have sufficient liquidity to meet claims upon it by the end of 1979. Third, the rapid loss in liquidity pinpoints the inappropriateness of

underwriting some classes of insurance and/or the insurance fee structure. If either some of these loans were underwritten or if the actuarily appropriate fee had been charged for high risk loans, the losses would be less or the total MIF would be much larger. In either case, the illiquid real estate and mortgage assets would comprise a much smaller proportion of the total fund. Fourth, the administration associated with defaults of such a real estate portfolio is substantial and costs absorbed by CMHC are increasing significantly. Fifth, the high proportion of real estate and mortgage holdings indicates that CMHC has not been disposing of its illiquid assets sufficiently quickly. Sixth, the need to pay claims has caused CMHC to sell securities in the MIF at inappropriate times, creating capital losses on the disposition. In 1978, these losses were $1.4 million. Seventh, the settling of insurance claims is creating losses for the MIF in the form of acquiring properties with market values below the insured value. In 1978, such losses were in excess of $57 million.

It is therefore clear that substantial problems exist in the operation of the insurance function of CMHC and that both the actual and potential future losses are substantial. Although some of these losses are the consequence of past actions, steps should be taken to limit these in the future.

B Financial Intermediary Activities of CMHC

In its financial intermediary role, CMHC obtains funds from the federal government through its capital budget and dispenses these funds for housing related loans. The true magnitude of this function is not reflected in the size of the capital budget, however, because the administrative costs associated with this lending are absorbed in the operating budget, and because CMHC funding is obtained relatively cheaply given the type of loan it is making. The implicit interest subsidy in its cost of funds is passed back to the Government of Canada which does not receive an interest return commensurate with its true risk, while the administrative costs remain with CMHC.

The magnitude of CMHC lending activity has varied considerably but is substantial. In 1978, advances from the capital budget were $1,133 million. However, as a result of the reduction of its intermediary role, these advances will decline substantially. This decline is already reflected in the capital budget for 1979, which is down to $495 million.

A number of financial problems are implicit in CMHC's intermediary operation, the most important of which are related to adequacy of its interest margin, the aging of its portfolio, and the riskiness of its loans.

Adequacy of the Interest Margin

The Corporation obtains funds from the government at the government lending rate and has generally lent these funds at this rate plus 3/8 of 1 per cent. More recently, however, CMHC has begun to lend at the same interest rate as that charged by private lenders for NHA insured mortgages. This corresponds to the lower end of the market rate. The interest margin is supposed to defray all costs associated with administering the mortgage portfolio -- which is now about $10 billion -- as well as other operating expenses.

The appropriateness of the size of CMHC's past interest margin of 3/8 of 1 per cent appears difficult to justify in the light of operating costs and the generally higher spread expected by private lenders. On the other hand, the Corporation has relatively low administrative costs associated with its funding from the government in contrast to private lenders for whom inflows represent a major cost, and has some very large loans which reduces the average cost per dollar invested. However, regardless of the appropriateness of this margin, CMHC is now facing an impending operating deficiency.

Aging Mortgage Portfolio

The aging of CMHC's mortgage portfolio will create losses on its administration of the portfolio for a variety of reasons.

First, as mortgage loans age, the outstanding balance of the loan declines. Since CMHC's interest margin is calculated on the outstanding balance of the loan, the interest margin associated with each loan declines over time, and since CMHC's mortgage portfolio has been aging, CMHC now finds itself with a large volume of very mature mortgages on which the income generated is relatively small. Second, since most of these loans still exist, the real administrative costs associated with them remain. Moreover, due to inflation, the actual costs of administration are increasing while the interest margin revenues associated with these loans declines. Third, during the period of high interest income, CMHC surplus earnings were returned to the Receiver General, preventing CMHC from increasing its earnings by reinvesting its accumulated surplus, which would have helped defray current rising costs.

The consequence of this is that regardless of the existing adequacy of the interest margin, the aging process will cause the costs associated with administering the mortgage portfolio to overtake the revenues generated from the margin and create losses on the outstanding loan portfolio. Moreover, it appears that this time has now arrived.

Application Fees

CMHC either charges no mortgage application fee or a fee of $35 per unit. CMHC consequently suffers losses in this stage of its operation since the costs of this procedure are considerably in excess of $35 per unit.

Riskiness of CMHC Loans

Most CMHC uninsured lending is implicitly high risk, since these loans are made as part of CMHC's social function. This has resulted in a number of mortgage defaults and the subsequent acquisition of real estate by the Corporation. Recently, the rate of these acquisitions has been escalating rapidly as a result of its social lending policy in the 1970's. CMHC's real estate holdings, combining those held directly and in the MIF, currently approximate 28,000 units and are expected to exceed 40,000 units by June 30, 1980. The size and rate of increase of these holdings have a number of implications.

First, large potential losses are likely since the book value of the real estate exceeds the market value. Second, reduced earnings will occur since mortgages in default generate no revenue and the rental return on the actual real estate is likely to be below the corresponding mortgage interest. Third, administrative costs are likely to rise considerably to manage the rapidly growing real estate portfolio. Fourth, the large holdings suggest an inappropriate sales policy since the retention of real estate holdings is an inappropriate function for CMHC. This in fact is borne out by the sales record, which indicates sales of 1,200 units in 1977, 6,300 units in 1978, and sales of 4,500 units to date in 1979.

From the foregoing discussion it is clear that CMHC is moving into a period of sharply reduced net revenues and likely substantial losses through its financial intermediary activities. Some of these losses are the inevitable consequence of an aging loan portfolio which generates reduced net earnings from a given yield spread as outstanding mortgage balances decline and administrative costs increase from inflation. However, the losses are also attributable to initiating high risk loans without a corresponding interest risk premium or complete failure to charge an appropriate application fee for mortgage loans. Even if CMHC lending practices are altered, the mortgage aging

process makes it inevitable that future losses will occur, but if the practice of making social loans without an appropriate risk premium is continued, the losses are likely to be considerably greater.

C Departmental Functions of CMHC

CMHC performs many functions in its role of conducting federal government social policies in the housing area. In this role, it receives funding from Budgetary Appropriations, interest earned on investments, and miscellaneous income. The amount of these funds and its expenditures in the social area underestimate the full costs of CMHC social activities because the administration of many of its activities (public housing, urban renewal, sewage treatment, etc.) are not fully compensated for, but have been funded in the past from its fast disappearing interest margin on its mortgage portfolio, because some losses incurred in its intermediary function are the result of socially inspired lending at subsidized rates, and because real estate owned by the Corporation is often rented at below market rents, generating implicit losses for CMHC.

Consequently, the social cost of federal housing programs exceed those explicitly indicated, and this probably tends to increase the size of these programs. Without giving account to the underestimate, CMHC expenditures on social programs were $ 694 million in 1978 and are projected to rise to $ 1,384 million by 1984. On the other hand, it must be remembered that the primary purpose of CMHC's department role is social, and while efficiency in the delivery of a given benefit is important, the size of the benefit to be delivered should be determined by social criteria, as well as financial efficiency.

Finally, it should be recognized when considering the overall financial implications of CMHC activities on the basis of the preceeding segmented role approach that considerable overlap and double counting might exist.

6 OPTIONS

A Introduction

The foregoing analysis indicates that there are very few reasons for continued large scale government intervention in the housing and mortgage markets in Canada, because of the current efficiency of these markets, the very high standard of housing, and the projected decline in new housing requirements during the next decade. Moreover, the analysis indicates that the financial costs associated with the large scale intervention in the recent past have been substantial and that, if existing practices continue, these costs are likely to increase considerably. It is therefore appropriate that the role of the federal government in housing and mortgage markets be reconsidered and an assessment made of the extent to which CMHC's current activities should be privatized.

B Criteria for Privatization

There are numerous criteria that can be used to assess the desirability of privatizing the various functions presently performed by CMHC, and for selecting the optimal privatization option in the event privatization is warranted. Among the appropriate criteria are the effects privatization might have on:

(a) resource allocation throughout the economy;

(b) the cost effectiveness in providing goods and services in the economy;

(c) economic stability;

(d) the conduct of social policy; and

(e) Canadian control of real resources.

The criteria may not equally apply to all CMHC activities; consequently, no attempt was made to rank the criteria, because it might be desirable to alter

the relative ranking of the criteria when analyzing different CMHC functions.

C Options for Privatization

Numerous options for privatization were considered, ranging from maintaining the status quo with improved financial arrangements to privatizing the financial functions of CMHC and restructuring its social programs.

The major advantages and disadvantages of the major options are set out below.

Maintenance of the Status Quo

The primary advantages of maintaining the status quo with improved financial arrangements are that it is administratively easy, that the cost effectiveness of CMHC would be improved somewhat, and that the social programs could continue to be integrated with financial functions. The major disadvantages are that the intermixing of social programs with financial activities would continue, distorting the cost of each activity and impairing the cost-effectiveness of each activity. The government would continue to conduct a number of unnecessary functions for which CMHC is not the most cost effective administrator. Furthermore, the speed of real asset dispositions will continue to be slow and the liquidity of the MIF remain impaired. Social programs would continue to have a broad target group. The cost-effectiveness of social programs will remain impaired because of duplication of activities with the provinces and because the management responsibility is outside the government level responsible for raising the bulk of the subsidy funds.

Alternatives to the Status Quo

Mortgage Insurance

Because NHA insurance was judged to be no longer a necessary public policy instrument, the Task Force considered two alternative methods by which CMHC could

discontinue its mortgage insurance function. In both methods, a federal role of re-insurance is envisaged.

The advantages to mortgage insurance not being a government activity are that CMHC would no longer increase, by large volumes, the government's liabilities and the illiquidity of the MIF would be reduced.

It was also recognized, however, that termination of CMHC insurance underwriting would increase the cost to those who would have obtained NHA insurance because the hidden subsidy would be eliminated in both the intiation fee and in the preferred interest rate. The withdrawal of the government from this area might create the possibility of insufficient mortgage competition in the mortgage insurance industry. Furthermore, high risk groups may not be able to obtain mortgages and the attractiveness of Canadian mortgage insurance investment to offshore investors might be reduced.

For these reasons, ways were examined to encourage a private company to take up the room left unoccupied by CMHC withdrawal, to institute a federal re-insurance program, and to maintain the current level of investment in mortgages by banks. With respect to the latter point, the current Bank Act limits the investment in privately-insured mortgages by chartered banks to 10 per cent of their Canadian dollar deposits. If this limitation is not adjusted once government insurance under the National Housing Act is discontinued, the effective level of investment in mortgages by banks will decrease.

Method One - New Company

This method envisions the creation of a new company initially to be wholly owned by CMHC that would take over the MIF and its liabilities from CMHC. The company would be sold to the public as soon as possible, but hopefully within a year of its creation. CMHC would thus terminate its mortgage insurance underwriting and management of the insurance assets and

liabilities. The new private company would continue underwriting insurance for its own accounts and would manage the remaining MIF liabilities.

Method Two - Contracting Out Management

This method envisions CMHC agreeing to terminate writing mortgage insurance as of some date, possibly December 31, 1980, and arranging for the private management of the MIF and the insurance portfolio. CMHC would retain the ownership and policy control of the MIF and the contingent insurance obligations. A variant of this is that part of the consideration for obtaining the management would be that the private corporation enter the mortgage insurance field and commence underwriting insurance when CMHC activity ceases.

Advantages of Method One - New Company

The advantages of this compared to method two are that it would generate government revenue on the sale of the Fund and its contingent insurance liabilities; create a new on-going viable private entity in the mortgage insurance field, which would increase competition in the industry; and provide some existing CMHC staff with employment opportunities. Terminating the operation would ensure that CMHC would not acquire additional real estate through the insurance operation and would eliminate the need for CMHC to give policy direction to the private manager of its existing Fund.

The disadvantages of this method are the advantages of method two.

Advantages of Method Two - Contracting Management

The advantages of this compared to alternative one are that it would enable CMHC to control the policies for managing the existing MIF, but release government from the operation and management responsibilities of the contingent liabilities and foreclosed real estate. It would ultimately enable CMHC to realize a larger net gain if the net present value of the MIF over

liabilities incurred, as the insurance lapses, exceeds the obtainable current market price for the MIF and its contingent liabilities.

The disadvantages of this method are the advantages of method one.

Introduction of a Contingent Re-Insurance Program

A contingent re-insurance program could be undertaken involving the offering of re-insurance to private insurers. It would be realized that under a re-insurance program, the government would not be guaranteeing loans but would be participating in the losses of private mortgage insurers, subject to specified maximum limits.

Such a re-insurance program could be used to reduce the shock to the capital market of the cessation of NHA insurance and to raise the security provided by private mortgage insurance to a level that is somewhere between that currently provided by private mortgage insurance and by NHA mortgage insurance. It would also increase the credibility of private mortgage insurance because of the association of the government, lead to some reduction in capital requirements for private mortgage insurers and so improve expected return on equity and also increase capacity marginally; and it would enable private mortgage insurers to withstand a higher level of claims than at present.

The program could also be used to encourage the introduction of new mortgage forms, such as Graduated Payment Mortgages, by insuring the excess loan balance under this scheme, and to affect the cyclical availability of mortgage funds by altering the conditions for re-insurance.

This program creates the risks that the government will become heavily involved in mortgage insurance underwriting through the back door, and that the re-insurance program might be used as a departmental tool.

Existing Mortgage Portfolio

The options considered were contracting out the management of the portfolio, selling the portfolio, or leaving things as they are. An in depth analysis of these options could not be undertaken because the composition and net value of the portfolio are unknown.

The general feeling of the Task Force, however, was that the management of the portfolio was an unnecessary government activity and that its disposal would raise considerable cash for the government. The offsetting disadvantage could be the realization of a significant loss which is currently on the books of CMHC.

The Task Force considered that the magnitude of benefit arising from disposition could be large enough to warrant an outside appraisal and assessment of the portfolio to enable a decision to be taken on this at a future date.

Real Estate Portfolio

CMHC presently owns and manages substantial amounts of real estate in its own portfolio and in the portfolio of the Mortgage Insurance Fund. The Task Force considered the options for handling CMHC's existing real estate portfolio on the assumption that it is inappropriate for CMHC to be the direct owner of large real estate holdings.

The Task Force considered management being turned over to the private sector on a decentralized basis and for these managers to conduct an aggressive campaign to sell these assets under the direction of a person to head this campaign.

The <u>advantages</u> of this are that it would relieve government of an unnecessary management operation for which it is not suited and in which it incurs considerable expense, and eliminate the pressure on government to provide hidden subsidies by renting property at below market rates.

The ultimate return on the asset could be maximized by conditioning the building for sale, by improving its appearance, and fully renting it at market rents and by substantially increasing the speed at which CMHC assets are sold. The liquidity for the Mortgage Insurance Fund would be restored at a faster rate than under existing procedures.

No major disadvantages to this alternative are apparent.

Social Programs

The following discussion of alternatives should not be taken as a suggestion that the federal government withdraw assistance from those people in need, but that it move in favour of programs that pinpoint need and deliver assistance efficiently. The Corporation should have the legislation to implement such programs.

The Task Force considered ways to modify federal involvement under public housing programs. The federal government could negotiate with the provinces with a view to withdrawing from the joint long term subsidy commitments by honouring, in a different form, all subsidy commitments involved in units under management which arise from the operation of the federal-provincial joint investment and federal loan programs. The Task Force did not include the Rural and Native Housing Program in this alternative, nor the rent supplement on privately owned units.

The advantages to this option are that it would disentangle federal and provincial roles and responsibilities in social housing and provide an incentive for more prudent management of subsidy costs because all subsidy funds would be raised by the level of government administering the program. This would make management more cost effective and would improve the allocation of resources.

The disadvantages to this are that if the provincial governments do not maintain the same level of subsidy to the existing clients, this could cause severe

dislocations to the client group. This would affect female-led single parent families and senior citizens the most. Also, if the lost operating subsidies exceed the interest savings and the management economies associated with the transfer, the financial costs to the provinces will increase.

Non-Profit and Co-operative Programs

The Task Force considered withdrawing federal funding with the thought of developing a more efficient delivery system for benefits to low income households. The objective would be to design a program where need targets were more specific and to separate measures to increase the supply of housing from measures which increase access to adequate housing at a reasonable proportion of income.

The advantages to this alternative are that it would terminate a program which has the potential for significant abuses in terms of the client group served and delivery inefficiencies and for which the government has undertaken long term subsidy commitments, without proper assurance they will go initially and throughout the commitment period to the appropriate target group. It would free resources to devote to the assistance of persons in real need.

The disadvantage of termination of these programs is that it would cause a 'sunk' loss of federal funds which have already been expended for the development of non-profit and co-operative projects which have not yet been approved for federal funding.

Rehabilitation

The Task Force endorsed the principle of assistance for rehabilitation but thought the program should be restructured to be more cost effective and to channel the assistance more directly to those in need of aid. Consequently, the Task Force considered that the program should be reviewed with the objective of specifying financial requirements for owner-occupants on the basis of net assets as well as income. In the

interim, assistance to landlords for rental accommodation could be withdrawn. Our discussion does not include Rural and Native Housing.

The advantages to the Task Force's objective are that the program will be more targeted to needy groups and delivered in a direct way.

Although there would be less rehabilitation carried out, it is questionable whether low income households would be greatly affected by this withdrawal.

Income Maintenance or Shelter Allowance

After considering the general housing supply situation expected in the 1980's, the needs of low income Canadians, and the problems identified with the above programs, the Task Force briefly considered the replacement of most existing social and departmental housing programs with direct grants to individuals. These grants could be conditional on attaining adequate accommodation at an appropriate proportion of income or they could be general income transfers.

Direct grants have the advantage of delivering housing assistance to the appropriate target group with minimum distortion to the housing market and with maximum efficiency.

A full analysis of such schemes was outside the purview of this Task Force. The scope and cost of such schemes were not investigated; similarly, the Task Force did not attempt to measure the impact on the market of such demand, in particular, whether a high enough level of demand would be created to stimulate an adequate level of construction and rehabilitation of existing housing stock.

Community Services Contribution Program

The Task Force considered termination of the program at the end of the current federal-provincial agreements but leaving the legislative authority intact so that

where a specific need can be demonstrated, CMHC could act.

The advantages to terminating the program are the withdrawal of a federal program which is essentially addressed as a municipal problem and the removal of responsibility from CMHC for a fiscal transfer program that is only very indirectly related to housing. Resources would be freed which could be used to meet specific housing needs identified.

One conceivable disadvantage to terminating federal funding for the program on an on-going basis is that the federal government will decrease its power, however vague, to improve community environments for Canadians.

Personnel Adjustment Program

The Task Force was concerned that any re-organization of the Corporation, resulting from this report, be implemented in such a way so as to avoid interrupting the career pattern of any employee. The Task Force considered ways to ease and smooth any transition for the employees. The main objective to be addressed is to make contact between CMHC staff and potential new employers and to make each party fully aware of their potentials and capabilities. The fact that CMHC personnel are not considered part of the federal civil service for employment purposes was considered a definite limitation of finding alternative employment for CMHC staff.

One possible way is to employ a consultant, experienced in the field of employee relocation, who is capable of providing a comprehensive counselling service and who has offices and qualified staff in all major centres in Canada. This consultant could have the authority to draw upon the resources of the Public Service Commission and to implement a comprehensive program.

D Conclusions

CMHC has carried out the dual functions of financial intermediary and social policy agency. The mixing of financial and social policy functions has meant that the costs of each operation are unclear and that the functions are not implemented in the most efficient manner. The private sector holds financial expertise and operating experience. The government's primary function in housing should be to implement the social policies appropriate to the day.

Decreased direct federal activity in the housing markets is warranted.

CMHC activities in mortgage insurance could be discontinued with little effect on public policy and with substantial operating savings and reduced contingent liabilities for the federal government.

The forecast operating deficit on the mortgage portfolio administration can be reduced by transfering management and/or ownership to the private sector.

The subsidy functions could be realigned in such a way that the federal and provincial roles are disentangled and programs more effectively directed to a specific target group in need of housing assistance.

The federal role in housing would then evolve to be a continuing concern with the supply of mortgage funds to be implemented through government re-insurance of all mortgages; a continuing concern with the distribution of and access to mortgage funds, to be implemented through the activity of lender of last resort at appropriate charges, for those individuals not serviced by the private sector; and a continuing concern with access to quality and affordable housing for those households who are not able to attain adequate accommodation on the private market at a reasonable proportion of their income, through the activities of rent subsidies, grants and loans for rehabilitation to owner-occupants, grants and loans for rural and native persons, or through income maintenance or direct cash

transfer programs, and through research and demonstration projects.

7 RECOMMENDATIONS

A Recommendations to the Federal Government

After careful consideration of all of the advice that has been received to date, the Advisory Committee recommends that CMHC activities be primarily in the area of social or departmental housing policy and that it essentially discontinue its financial functions. The specific recommendations to effect this are set out below.

1. That CMHC be maintained in place with its current legislative authority.

2. That CMHC focus on identifying those areas where federal government involvement is required to provide adequate shelter for low income Canadians. The primary function of CMHC is to conduct federal government social or departmental housing policy.

   In this connection, that the Minister Responsible for CMHC (hereinafter 'the Minister') and the Minister of State for Social Policy direct a study on the feasibility and financial cost of replacing most existing social and departmental programs with a direct income maintenance or direct housing allowance scheme and report back to Cabinet by the end of 1980.

3. That the following CMHC departmental functions be given special consideration, as described:

   a. Public Housing (50 year subsidy commitments)

      That the government commence negotiations with the provinces with a view to eliminating subsidies by January 1, 1982. The settlement of long-term commitments in this connection might include forgiveness of mortgage commitments on, or divestment of federal equity

in public housing. No new capital projects should be considered at this time, nor any new long-term subsidy commitments on provincially owned housing.

b. Community Services

That the Government of Canada notify the provinces that the program will terminate as of December 31, 1980 when the current federal-provincial agreements expire. That federal contributions be made on eligible and approved projects until March 31, 1982.

c. Residential Rehabilitation

That no further funding be considered for landlords until this section has been carefully reviewed. That CMHC carefully review the loan and grant program with respect to owner-occupants with a view to:

i. securing the funding from private sources, and

ii. making grants only after net assets as well as income have been considered.

d. Non-Profit and Co-operatives

That funding be withdrawn from both the public and private non-profit and co-operative programs with the thought of developing a more efficient delivery system of benefits for low income households, but that the implied subsidy commitments contained in fully committed development funds be honoured.

e. That all operating costs related to CMHC social programs be recovered from the Minister through appropriations.

4. That CMHC cease writing mortgage loan insurance, except in extreme circumstances when the private

market cannot supply this service in remote areas. CMHC would stop underwriting insurance at a time designated by the Minister once a decision has been made about the best mechanism to be used to remove mortgage insurance activities from CMHC. That the Minister employ consultants to advise him on the mechanism to be used. While there are two general routes that can be considered -- one involves the sale of assets and liabilities on an on-going basis, and the other involves the management of the liabilities of the mortgage insurance portfolio and of the assets of the Mortgage Insurance Fund -- we recommend sale of the assets and liabilities. That the Minister report back to Cabinet on the preferred mechanism by the end of February, 1980.

5. That the Minister of Finance be asked to amend the Bank Act to allow banks more flexibility in the ratio of Canadian mortgage loans to Canadian dollar deposits.

6. That the government provide re-insurance for the mortgage industry. Such re-insurance would be short of a government guarantee but would raise the security provided by private mortgage insurance to a level that is somewhere between that provided currently by private mortgage insurance and by National Housing Act mortgage insurance. It could also be used to serve other housing needs.

7. That the Minister appoint an individual to immediately assume responsibility for the management and sale of all the properties currently held by the Corporation through foreclosure in connection with direct lending or the mortgage insurance program. The individual should be free to take such actions as are required to maximize the return on the assets involved. It is equally important that this individual be instructed to deal in the most sensitive manner possible with the very urgent personal problems that confront many individuals who have been encouraged into buying housing which is now beyond their means.

8. That the Minister appoint an individual to:

   a. arrange for the management of the mortgage portfolio to be contracted out, and

   b. assemble the information required to sell the portfolio and then on the instruction of the Minister, to liquidate the portfolio. (If any portion of the portfolio is to be sold, it should be offered to those who are on the mortgage at the same discounted price, before any bulk transfer.)

9. That those employees who are displaced by the re-organization of CMHC be treated as though they were civil servants, be allowed to compete for positions in the public service for a two-year period, and be placed on an initial 6 month priority list. The Minister should appoint an individual to implement a personnel adjustment program which involves careful management and attention to each individual so that employees of the Corporation will undergo no interruption in their career patterns. The individual would have the authority to call on the resources of the Public Service Commission and the program would encompass the components listed in section 6.4 of the previous Chapter.

B Financial Implications

Insurance Function

Method One - Creation of a New Company

The Superintendent of Insurance estimates that a capital investment of $25 million would have to be made into the new company to enable it to meet the regulations of the Insurance Act dealing with the ratio of equity to liability.

The Consolidated Revenue Fund (CRF) would be freed of the responsibility for funding the illiquid Mortgage Insurance Fund after the new company had been sold. It

is estimated that loans required from the CRF in 1980 will amount to $140 million, unless there is a substantial acceleration of real estate sales.

CMHC would be freed of the loss incurred in the initiation of mortgage insurance. This would result in a saving to the Corporation of $15 million a year.

The Government would no longer incur large volumes of additional liabilities and foreclosed real estate.

Method Two - Contracting Out Management

This proposal requires no capital investment and allows the CRF to take the residual of the Mortgage Insurance Fund as and when liabilities have been discharged. The CRF would be required to finance the loans for the Mortgage Insurance Fund. With careful and prudent management of the mortgage insurance portfolio, one would expect to minimize the losses associated with foreclosure and very much reduce the turn around time betweeen foreclosure and resale and thereby substantially reduce the cash demands on the CRF.

The Corporation would be freed of the loss incurred in the initiation of mortgage insurance. This would result in a saving to the Corporation of $15 million per year.

The Government would stop incurring additional liabilities.

Introduction of a Re-Insurance Program

This program would be financed out of the fees as established by the Superintendant of Insurance.

The exposure of the government would be considerably less than under the existing arrangements of NHA insurance.

Real Estate Portfolio

The Corporation has almost $500 million invested in real estate that would be sold over the next five years. This will result in a net inflow of $500 million into the CRF and the MIF less the cost of operation and sale, plus rental income before sale, and plus or minus the difference between current valuation and sale price. By careful management of each individual structure and the adjustment of rents to market prices, we would expect to maximize the return by putting full occupancy buildings on the market.

Savings for Subsidy Functions

The following table sets out the expenditures which would not be made and therefore the cash which would not have to be drawn from the CRF, if the recommendations were implemented and if the negotiations with the provinces on the long-term public housing subsidies were successful. They do not include consideration of the cost to the government of settling the loans and equity for public housing. The figures should not be considered as net savings to the government. Rather, these expenditures reflect the general magnitude of a direct grant program which could be considered to replace the current social housing programs.

The figures are based on the CMHC 1979 approved 'A' base budget.

C Federal-Provincial Considerations

1. The privatization of the insurance function is expected to be viewed favourably by all but some provinces and territories which have large rural populations which might not be well serviced by the private sector. The re-insurance provisions or other special provisions should assist these populations. These provinces are also expected to seek a continuation of CMHC mortgage lending functions, on a last resort basis, for rural areas.

Reductions in Non-Budgetary and Budgetary Advances if Recommendations Implemented

$ millions

Non-Budgetary Cash Advances	80/81	81/82	Year 82/83	83/84	84/85
Public Housing - No new capital commitments after 1979.					
S. 40 (reg.)	21.1	37.0	36.8	39.8	43.1
Rehabilitation - No new commitments after 1979.					
for rental and non-profit	3.2	4.3	4.8	5.0	5.2
Sub-Total	24.3	41.3	41.6	44.8	48.3
Budgetary Cash Advances					
Public Housing - No new subsidy commitments on new construction after 1979.					
S. 40 (reg.)	-	0.5	3.1	7.5	12.0
S. 44 (prov. owned units)	-	0.9	4.8	11.0	17.9
Public Housing - Existing stock: expenditures not made if provinces agree to terminate federal subsidies, Jan. 1, 1982.					
S. 40	-	-	59.1	69.0	72.8
S. 44	-	-	187.4	219.4	232.4
Non-Profit and Co-operative - No new subsidy commitments after 1979 except for units implied in fully committed development funds.	1.0	13.6	37.5	70.2	108.4
Rehabilitation - No new subsidy commitments after 1979.					
for rental and non-profit	17.3	26.1	30.8	30.8	30.8
Community Services - Termination after 1980.			250.6	250.6	250.6
Sub-Total	18.3	41.1	573.9	658.1	724.7
Total	42.6	82.4	614.9	703.3	773.2

2. The provinces may react negatively to a large amount of real estate being sold on the market at one time. Tenants facing rent increases could approach the provincial government for a rent supplement. When this occurred in one province last year, that province was not happy about tenant pressure to increase the government's subsidy budget by a large amount over a short period of time.

3. All provinces are currently operating their own housing programs to meet the housing needs which they perceive to be priorities. Without exception, provinces consider that programs designed by the federal government to apply equally to all provinces are not the best way to meet the housing needs perceived as priorities by their governments. Provincial governments seek maximum flexibility in applying federal funds to provincially perceived housing needs. Provinces consider federal-provincial administration of housing programs a duplication and overlap of federal and provincial government services. The Premiers called for a reduction of this at their 1978 conference in Regina.

   Federal and provincial agency negotiation on this have not progressed very far, however, because the provinces appear to prefer duplication to an elimination of federal funds. For this reason, provinces can be expected to press for continuation of the Rehabilitation and Community Services Contribution programs. The phasing out of the Rehabilitation program might be a minimal acceptable position to them. They might attempt to have the Community Services funds replaced through increases to other programs such as the Established Program Financing.

4. Provinces are particularly concerned with the rising cost of public housing subsidies and are seeking alternative ways to control expenditures. Most provinces would react strongly to suggestions by the federal government to limit federal expenditures on public housing units currently

under long term contract for cost-sharing. One province has suggested a settlement of the public housing debt and the federal expenditures committed in subsidy contracts. The reaction of other provinces to this suggestion has not been enthusiastic. Provincial interest in seeking new arrangements for existing commitments might be dependent upon a new federal program which relieves provinces of their subsidy costs.